

Global Trade and Investing abroad

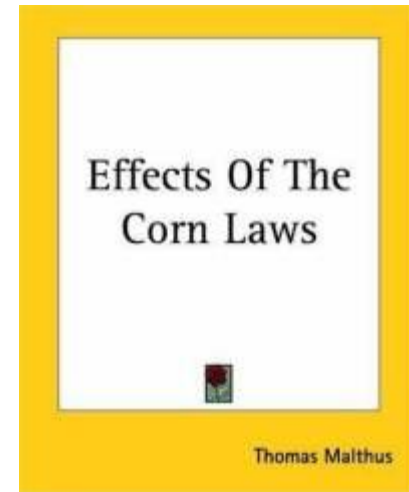
A Primer

Trade Issues

- Immigration/Emigration
- Currency
- Barriers
- Absolute v Comparative Advantage
- Other Reasons to Trade
- Bilateral Trade
- Trading Blocs
- Intergovernmental Organizations



Evolution of Trade



-18th Century- Mercantilism

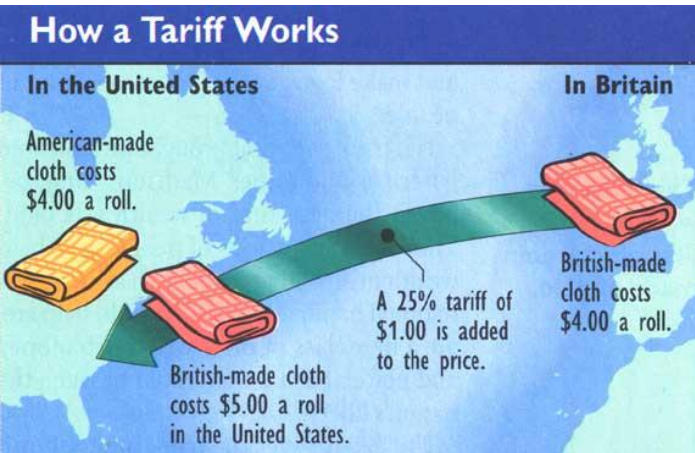
1776 Adam Smith and Absolute Advantage

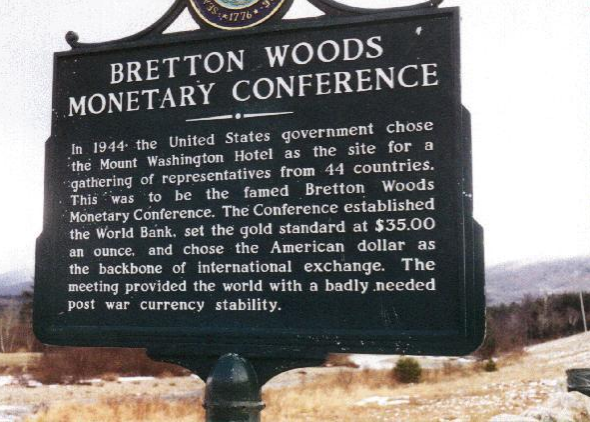
-19th Century—HUGE Trade-> Reduced Barriers

→ David Ricardo and Comparative Advantage



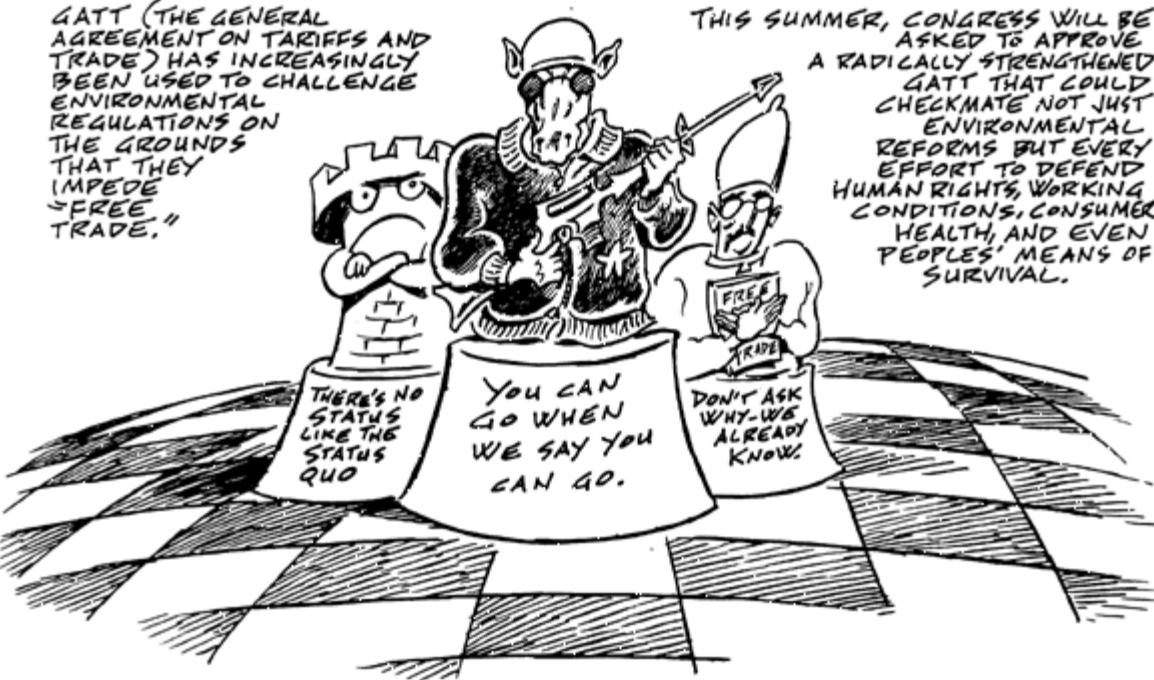
-Post WWI-> Great Depression-> Currency Devaluations and Trade Restrictions





BUT WHAT HAPPENS WHEN THEY BE-GATT the BEGINNINGS?

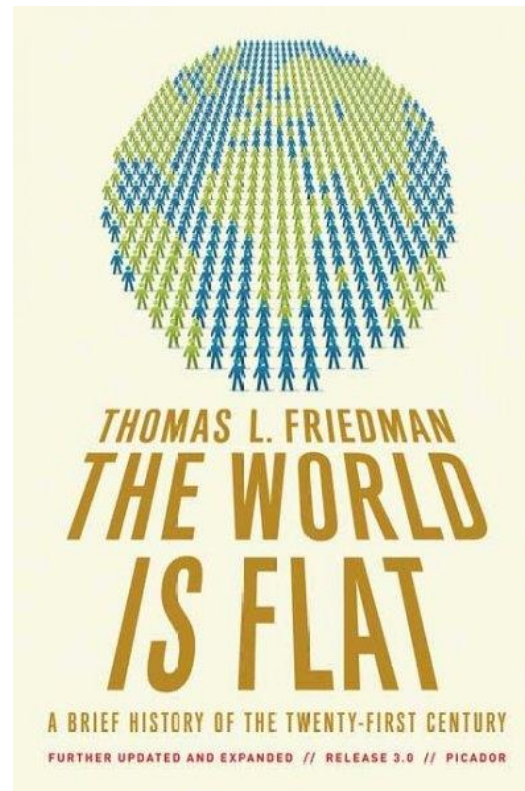
GATT (THE GENERAL AGREEMENT ON TARIFFS AND TRADE) HAS INCREASINGLY BEEN USED TO CHALLENGE ENVIRONMENTAL REGULATIONS ON THE GROUNDS THAT THEY IMPEDE "FREE TRADE."



- Post WWII-> (Bretton-Woods)
 - GATT, IMF, World Bank, Pegged Currency, Reduced Trade Barriers



“would you rather be an average person in Poughkeepsie or a genius in Bangalore”





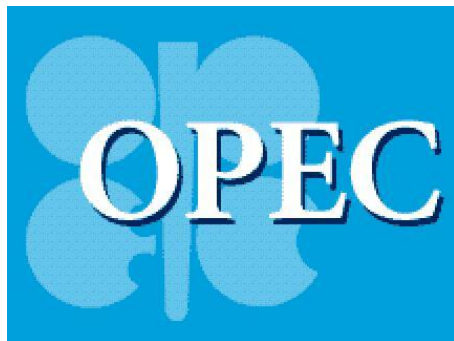
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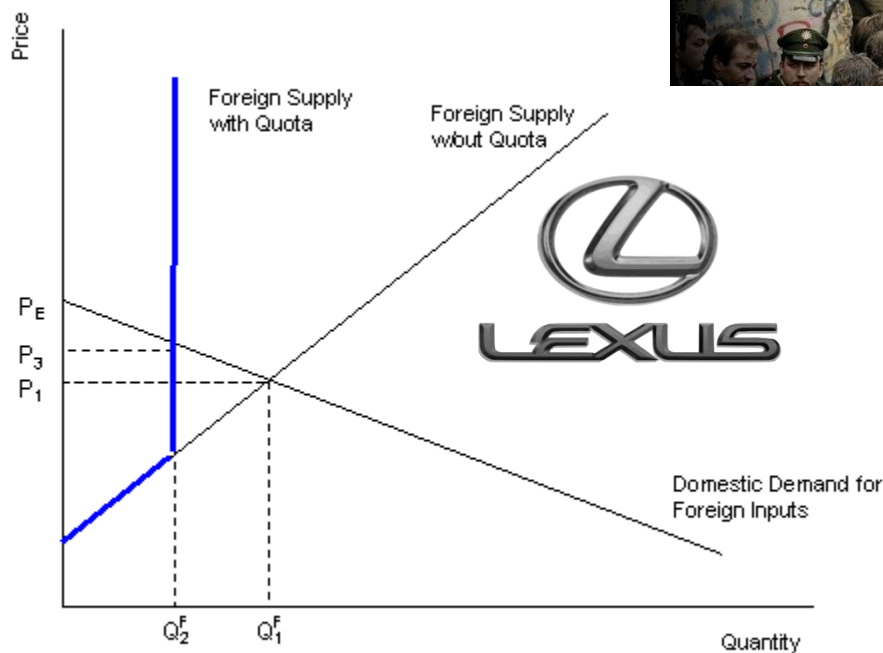
Gold Standard

http://www.youtube.com/watch?v=iRzr1QU6K1o&safety_mode=true&persist_safety_mode=1&safe=active

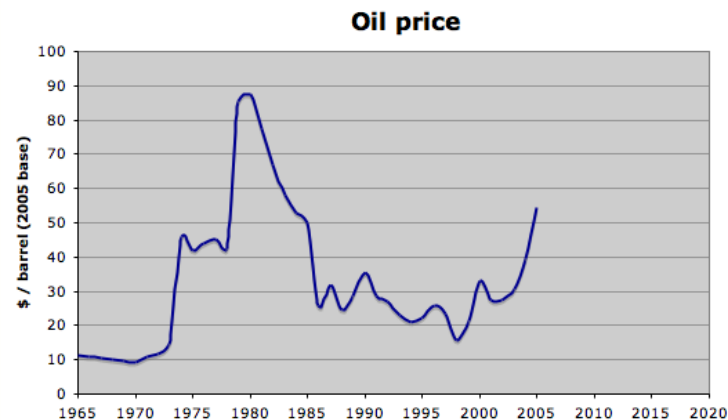
- European Common Market forms, Japan rises-
- Post 1970s- End of gold standard ->Free Floating Currencies- OPEC, Trading Blocs,



- 80s Global Trade expands, Common Market->EC, S. Korea, Taiwan, Singapore
- Communism falls, GATT becomes WTO, G-7



Graph 6



- 90s-> EC->expands, creates Euro, NAFTA other Trading Partners, Irish Tiger, China opens up Trade, Major Hiccups in global Finance and Currencies, Investment in Dev. World

And...

- 2000s-> Finance Global, China and India, World is Flat?—*would you rather be average in Poughkeepsie or a genius in Bangalore- has the answer changed?*
- Immigration/Emigration issues,
- 2007 Recession/Global Finance Collapse
- Today? Euro? China? India? Brazil? US Trade Deficit? OPEC?

Risk v Reward- Why Trade?

- Often the higher the risk, the more the investor demands as a return on their money (capital)
- Investing abroad can be quite risky- weak government structure, corruption,
- Consider the stability of your investment
- 3rd World countries have high risk and often high reward

Currency Value- A 5% reduction in your currency value could negate your profits!!!

Is the currency stable?

- Political or Economic turmoil

Is the currency free floating or pegged?

- If pegged is it likely to be devalued or raised in value?
- If the currency is free floating has the government intervened to maintain the value and if so, can that be continued

Mercantilism

- World is Finite
 - Trade->Zero sum gain, my gain is your loss
 - Retain all trade within the mother country and use colonies for resources (ie. Navigation Acts)
 - To the extent Trade occurs—Trade Balance-Exports-Imports->positive
 - High Tariffs, limitations on trade
- Mercantilists also->government actively engaged in economy (roads, canals)

Absolute Advantage

- Smith,
 - Product Poss. Curve
 - France produces 100 bottles of grape juice (this is HS) or 20 sheep
 - Britain produces 50 bottles of grape juice (this is HS) or 40 sheep
 - Who does what?

Getting Beyond the PPC –Part II- Comparative Advantage

- Other than Entrepreneurial Ability there is one other way to get beyond the Curve
->TRADE!!! And Specialization
- Comparative Advantage- Remember MJ and Mr. Balazs (aka MB), MJ was better at everything but so much better than MB at basketball that MJ specialized at BB and MB at typing

AND -No 2 countries both of whom have a McDonald's have since fought a War (ok-1)



....and...

- When we last visited our PPC---keep'n it simple→ slope constant→ we'll change some #'s
 - France 100 bottles- grape juice
 - France 20 sheep
 - Britain 30 bottles- grape juice
 - Britain 15 sheep
 - ABSOLUTE ADVANTAGE?→FRANCE→SO->FRANCE SHOULD MAKE EVERYTHING?
<except freedom fries>

NO!!!!!!!

- 1ST COMPARE THE RELATIVE COSTS FOR EACH SOCIETY!
- France's cost?
 - How expensive is it for France to make a bottle of grape juice?
 - How expensive to produce a sheep?
- ? Britain's cost?
- ? France/Britain produce?
- ? Trade –FIGURE IT OUT FOR YOURSELF!

But I thought that the PPC was a curve?

- YES---AND THAT MEANS THE RATIO'S
CHANGE
 - LOOK WHERE EACH SOCIETY IS
PRODUCING AND THE SLOPE—RATIO OF
PRODUCTION
- THE DIFFERENCE IN THE RATIO=
OPPORTUNITY TO TRADE

*EVERY ECONOMIST IN THE WORLD
ACCEPTS THE THEORY OF COMPARATIVE
ADVANTAGE*

So why don't we have open borders?

- Infant industry theory—ALEX. HAMILTON
- Domestic Pressures
 - Dislocation of industries
 - Inequitable impact
 - Structural unemployment
 - Distrust of other countries commitment
 - Lobbying
 - Nationalism?

ARE YOU FOR STEEL TARIFFS TO HELP THE STEEL WORKERS
OR AGAINST THEM TO HELP THE AUTO WORKERS?



Cheating...who'd do that...and can I too?

- Non-Tariff Barriers

- Regulation

- Shipping—one access of entry—bottlenecks
 - Regulation criteria- NO mutated gene veggies/grain?

- *Voluntary* Quotas (Quotas violate WTO)

- Hidden Subsidies (real one's might violate WTO)

- “buy American” (violates WTO)

- Currency manipulation



Figure 1

Who Supports Free Trade?

Opposes Subsidies		
	No	Yes
Yes	Isolationists	Free Traders
No	Interventionists	Internationalists
		Opposes Trade Barriers

Interest Rates and Currency Values

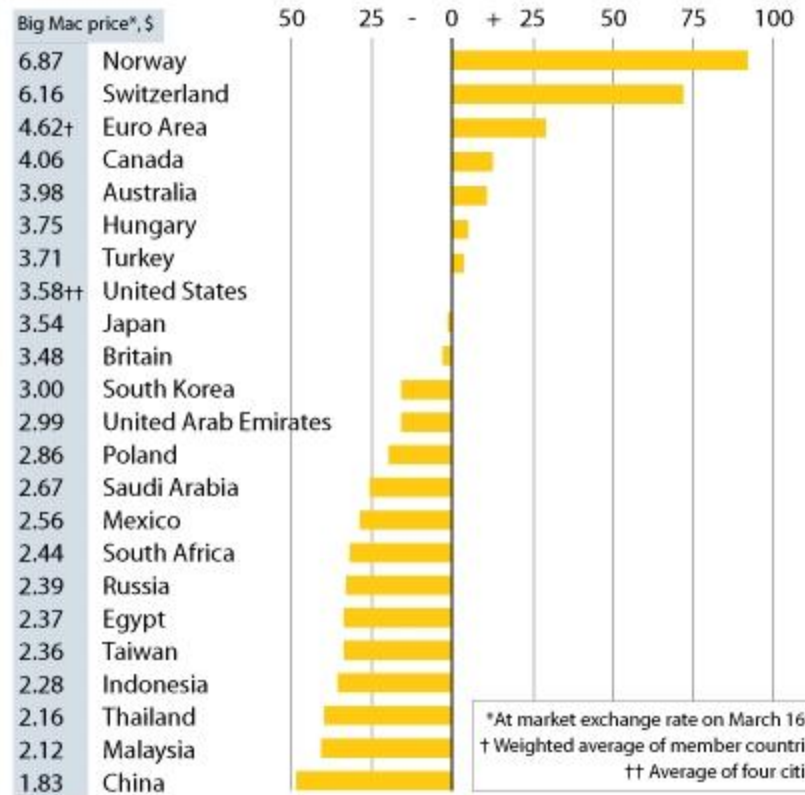
Interest is money you receive when you deposit money

- High Interest rates -> increase in demand for currency -> currency value rise
- Low interest rates -> decrease in demand
 - Governments can influence interest rates
 - <Current US Federal Reserve Policies keep interest rates low-> decline in dollar value



Big Mac Index

Local currency under (-)/over (+) valuation against the dollar, %



Source: McDonald's, The Economist

WWW.AGORAFINANCIAL.COM

Bonds versus Equities

we've done this before

- A Bond is a “loan”
- Equity means that you have an ownership interest in a company
- Bonds pay interest and are stable
- Equity can give dividends, but increases/decreases in value have more to do with the strength of the company



Government Bonds

- Governments, including the US borrow money
 - In the US investors buy treasury bills
- Banks lend money to Countries as well
- Again the higher the risk the better the interest rate that the lender can demand



Investing in a Foreign Market

Foreign Corporations

Are they multinational (eg Daimler-Benz) or primarily domestic corporations in that country?

Who are the potential consumers in the country?

Is this an export based business?

Risks of nationalization, corruption etc...

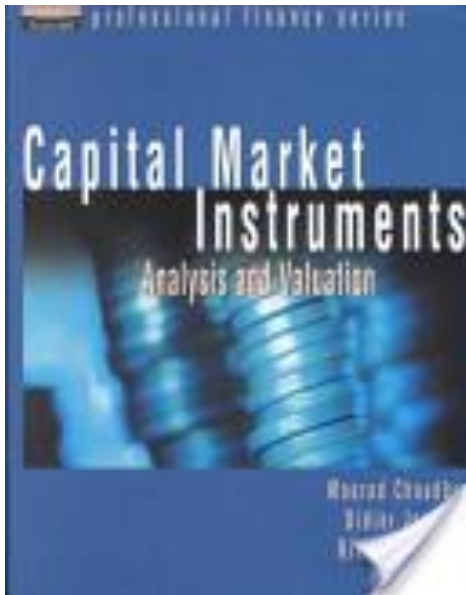
Domestic Corporations manufacturing or selling abroad

- Example → Nike sets up a plant in Vietnam
 - What factors are you going to consider before establishing a presence?
 - What restrictions does this country place on foreign entities?
 - Other issues
 - Educational levels of local population?
 - English speaking?
 - Age of population?



Other types of Restrictions

- Limit on taking money out of the country?
- Repatriation of profits?
- Joint ownership? (or in case of China → access to trade secrets)



Economic Unions



- Intergovernmental Organization
 - WTO (Originally GATT)
 - 100+ Countries, tries to reduce trade barriers across the globe, forum to address trade issues
- Regional
 - EC—European Countries- common currency? open borders—United States of Europe?
 - NAFTA- North American Free Trade Agreement, less integrated than EC





What's the future?

Greater integration of Economies?

- Larger Multinational Corporations?
- Copy Asia? More managed economy?
- Capital restrictions?
- Common Currency or currency manipulation?
 - Will the US\$ remain the World's "reserve" currency?
- Reduced Trade Barriers? What about farmers in Developed World?
- Resurgence of OPEC and its' like?